Wholesaler roundup

Continued from page 17

helping wholesalers expand and diversify customer bases.

Many wholesalers were also trying to consolidate and upgrade distribution facilities so they could affect additional cost savings. A number of companies had automated centers with computers, and a few of the bigger companies were experimenting with more advanced types of technologies like radio frequency picking and fully automated pickers.

Companies were still closing their smaller DCs and consolidating them into newer and larger facilities with the capacity to generate higher volumes at lower costs.

Companies this year were also talking about the need to improve their buying power, and to do this many sources said they needed to develop better relationships with manufacturers, particularly manufacturers of H&BAs, OTCs and sundries.

"You're seeing the good wholesaler work hard to make himself important to the manufacturer," said Robert Walter, chairman and chief executive officer of Cardinal Distribution, Inc.

"We have to show the manufacturers that we can sell programs as well as price. The manufacturer is willing to make more aggressive discounts available if we can show that we can promote their products. As wholesalers, we have to go after this business so we can earn the rebates," Walter added.

Most wholesalers thought this year's acquisition activity was not going to turn into another trend. "There are not that many companies left to be acquired," several sources pointed out, "and most of the major companies are still busy digesting the fruits of their earlier acquisitions from 1984 through 1986."

'If you read the speeches that management at some of the major companies make, you'd think we were shooting for fifty-percent margins. But when you look at what's happening in some of the markets, you realize there are some companies not even making five percent. There's no safety net in the margins we have now.'

–Michael Quinn
president, coo, Cardinal Distribution

In most cases, wholesalers who represented the small to mid-size volume companies were less likely to report that margins were stabilizing or that "cutthroat competition" was ending.

To get a fix on the trends and issues from as many perspectives as possible, *Drug Store News* interviewed a broad spectrum of executives. Here is what the industry thinks about the year just ended, and the year coming up.

Cardinal Distribution Inc.

Robert Walter, chairman and ceo of Cardinal Distribution, expressed an optimistic view of the industry and of Cardinal's future growth prospects. Sales and earnings were up substantially, said Walter, adding that pricing is starting to stabilize.

"People are being more realistic about margins," he said. "You see less competition to get market share based on price alone, at least from the major players.

"The smaller companies who don't have a lot of services to offer are still using price as a wedge to build volume," Walter said.

However, Mike Quinn, Cardinal's president, said, "If you read the speeches that management at some of the major companies make, you'd think we were shooting for fifty-percent margins. But when you look at what's happening in some of the markets, you realize there are some companies not even making five percent. There's no safety net in the margins we have now.

"We're concentrating on the northeast, where we're number one, and we're relying on our value- added operations to attract and hold customers," Quinn added. "We're also investing in research and development, so we can continue to improve our systems approach to our business."

Both agree that there are other trends developing that are helping wholesalers become more profitable.

For example, Walter said he sees a positive trend for hospitals, which have been notoriously slow about paying their bills, to improve their payment programs.

Walter and Quinn also noted that the Voluntary Hospitals of America, whose members control about 25 percent of all the beds in the country, recently reduced its network of wholesale suppliers from 16 vendors to nine, of which Cardinal was one.

Cardinal has also developed a new software package for hospitals called Accunet.

Bindley Western

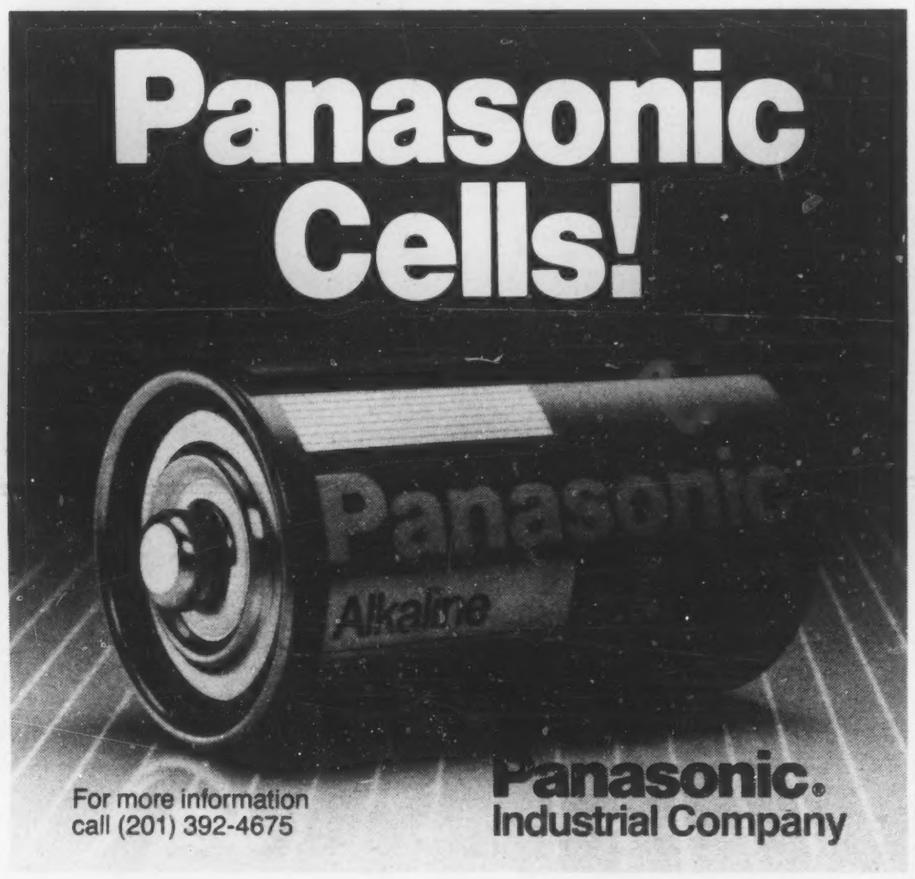
In Indianapolis, Bill Bindley, the chairman and ceo of Bindley Western, said the wholesaler has been moving on several fronts to improve overall profitability.

Bindley has consolidated several small facilities into larger centers, and has automated in a number of areas.

At the end of the year, Bindley will also open a new facility in Dallas, four times larger than the one there now.

Like many other companies, Bindley is also moving to broaden its mix into a full line. The company is expanding its mix of H&BAs and sundries

Continued on page 19



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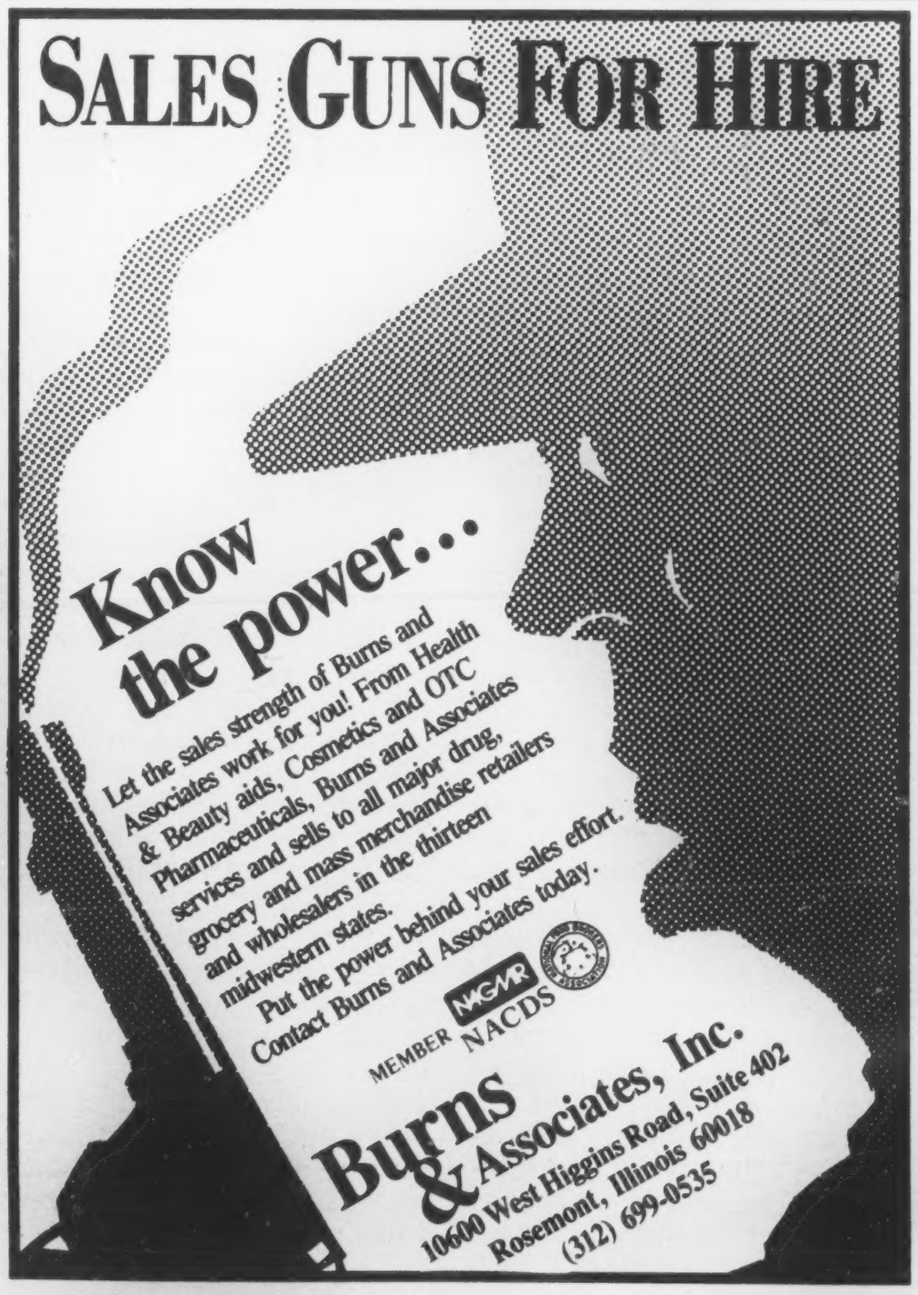
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Wholesalers TRENDS

Wholesalers seek stable margins

Continued from page 18
and is also offering catalog programs for deal merchandise.

"We feel that with the competitive pressures on the pharmacy side of the business, we have to offer a full range of services to attract a broad customer base," he said.

By 1990, Bindley believes he'll be able to increase his share of H&BAs, OTCs and general merchandise sales to between 15 percent and 20 percent of his total sales, up from 5 percent now.

Bindley is also trying to expand its generic program. "Generics," said Bindley, "give us better margins, and at the same time they allow us to provide an added service to our retail customers."

Bindley now has over 1,100 items in its generic line. Bindley hired Keith Johns, who used to manage pharmacy professional services for Hook Drug, to head up Bindley's generic distribution company, GlenLawn Generics. Bindley also sells its generic private label line to non-competing wholesalers.

Bindley thinks margins and prices won't effectively stabilize until the industry "stops trying to buy market share. The only way to buy market share now is to go out and offer a better price.

"Instead, the competition should be based on service—special programs that are geared to assist the retailers and streamline their operations."

Bergen Brunswig

In California, Bergen Brunswig is also striving to stabilize margins.

Last year, Bergen exceeded its profit goals by more than 40 percent. Phil Engle, president, attributed success to marketing programs which provided customers, both retailers and hospitals, with a growing number of value-added programs; to forward buying, which enabled Bergen to buy against price increases; and to their continued consolidation and upgrading of facilities which improved cost efficiencies.

"The gross margin erosion has at least slowed a little this year," Engle said.

"There's so much new coming out in pharmaceuticals, that it would be hard to accomplish a large shift in the sales mix and still remain a pharmaceutical supplier," he added.

What wholesalers plan to do to enhance value-added services to their customers

Service	During the next two years, the % of wholesalers who plan to modify their value-added services		
	Will add more	Will do less	Will stay the same
Point of purchase aids	83%	0%	17%
Planograms	63	0	27
Promotional/advertising support programs	88	0	12
Co-op ad dollar programs	83	0	17
Product price labels	33	0	67
Shelf price update	38	0	62
Price updates	42	0	58
Store remodeling programs	43	0	47
Store fixturing programs	33	0	67
Accounting/bookkeeping services	29	5	66
Third-party claim processing	61	0	39
Help customers bid on managed healthcare business	48	0	52
Extended dating on opening inventories	21	4	75
Direct loans for expansion/ acquisition, etc.	30	13	57
Co-signing loans for retailers	17	26	57
Arranging financing with third parties such as banks, etc.	42	4	54
Site selection	39	0	61
Pharmacy system software	52	13	35
Point-of-sale software	65	9	26
Scanning software	70	4	26
Pharmacy computer hardware	39	22	39
POS scanning/computer hardware	61	13	26
Host support for computers	57	4	39
Inventory reports	54	0	46
Financial/management reports such as P&L statements	30	9	61
Product movement reports	58	0	42
Business insurance	20	10	70
Private label programs	74	0	26

Source: *Drug Store News*/NWDA 1988 Wholesaler Survey

McKesson Drug

Also in California, megagiant McKesson Drug is experimenting with some new state-of-the-art technologies.

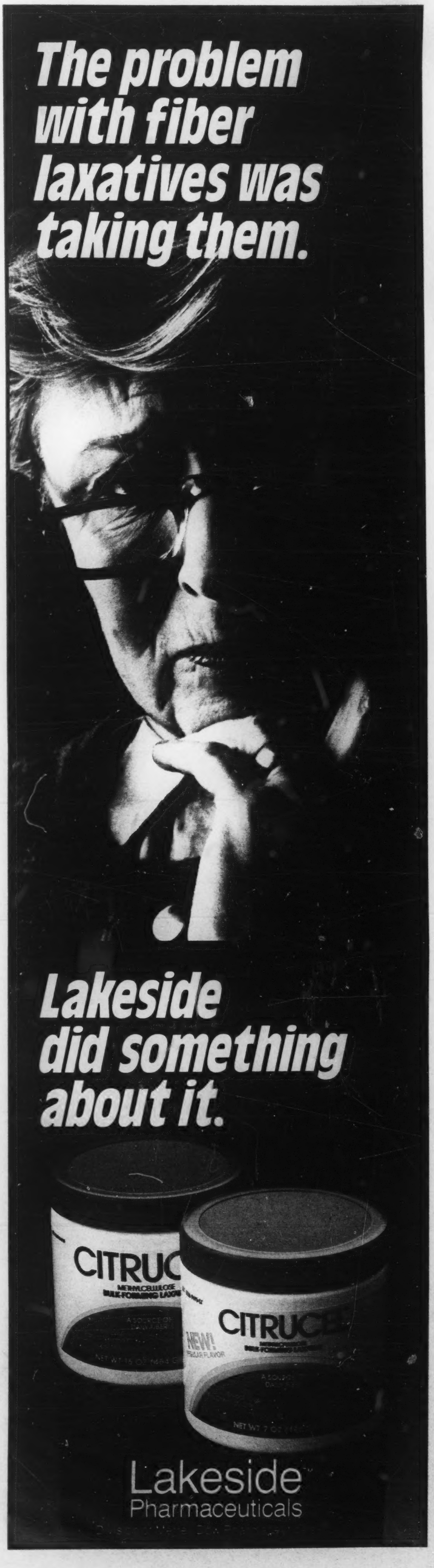
Joe Polastri, president of McKesson Drug, said McKesson is beta-testing a system that will eliminate all excessive handling of a product. Polastri said the system is "one of a kind" and that it has applications for automating the receiving and storage of product as well as for picking. "It's very cost effective," said Polastri. "It means we'll have to handle a product just once."

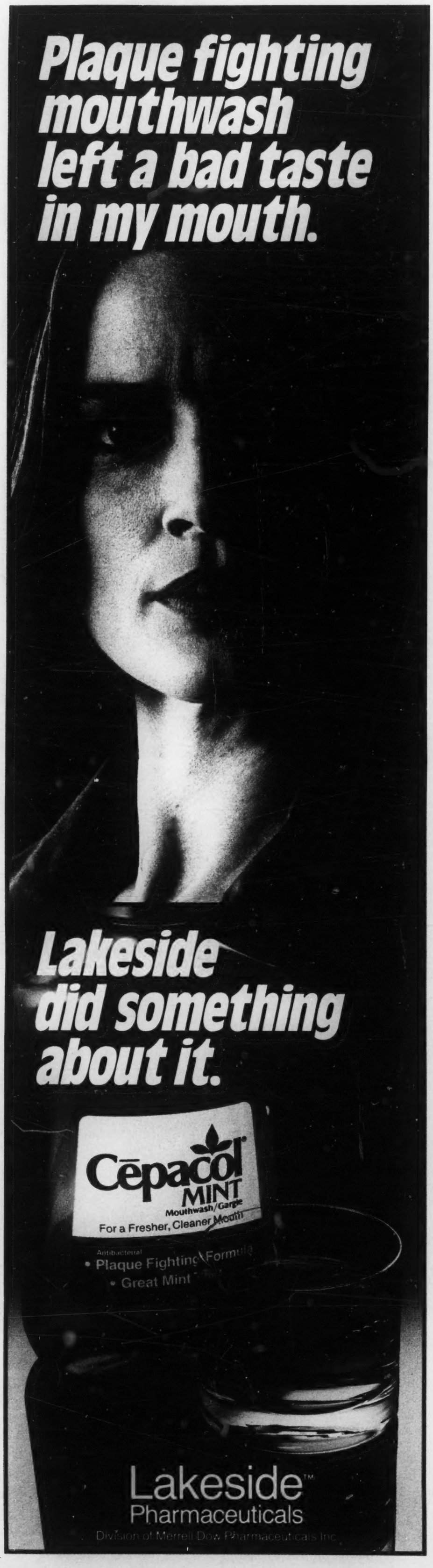
Polastri said McKesson will

Continued on page 20

'There's so much new coming out in pharmaceuticals, that it would be hard to accomplish a large shift in the sales mix and still remain a pharmaceutical supplier.'

—Phil Engle
president, Bergen Brunswig





TRENDS

Wholesalers

Wholesalers seek stable margins

Continued from page 19

begin an operational test of the system around the first of the year in the Sacramento warehouse.

McKesson is also continuing to consolidate its houses. Two DCs were consolidated and reopened in a larger warehouse in Tampa last June. Spectro Industries, a subsidiary, also moved into a bigger facility in Massachusetts.

McKesson had an excellent year last year and continues to do well in 1988. "The market is stabilizing," he said. "There's not much activity in bankruptcies, generic prices have stabilized, and the market is active. Business is good for everyone."

Yet Polastri said there will still always be some "cutthroat" competition in certain parts of the country.

To see if McKesson can improve margins by expanding product mix even further, McKesson is also experimenting with a novel kind of joint venture with its mass merchandise division.

"We're testing using the facilities of our mass merchandise rack job division to bring these kinds of products and services to our wholesale customers," he said.

"We've been testing the program for about six months with about 40 customers. The customer orders the goods through our system. The orders then go to the service merchandise division to fill. They fill it and they send it to our warehouses. Then we deliver the goods to our customers."

Polastri said the program makes about 20,000 more items available to McKesson's customers, including such things as hair care accessories, hardware and automotive products.

FoxMeyer

In Texas, FoxMeyer is spending this year focusing on getting its house in order under new management.

Bill Tauscher, FoxMeyer's charismatic chairman, resigned last July to pursue other business interests, and he was replaced as president by Bob King, a pharmacist who has spent 10 years with FoxMeyer, the most recent as president of the FoxMeyer Drug Co.

King reports to Larry Farley, who is now chairman of FoxMeyer as well as the cfo of parent, National Intergroup.

No one in the industry was very surprised by Tauscher's exit. Most sources, including King, said that his departure was "destined to happen," partly because Tauscher was used to being the number-one player at the old FoxMeyer. Also, it is believed Tauscher was not as comfortable being in a slightly less powerful position, once FoxMeyer was acquired by National Intergroup. However, he left primarily because of the many outside interests he had.

FoxMeyer's new management, under National Intergroup's direction, is focusing on the core business of drug wholesaling.

King said the company has been trying to stop its own involvement in cutthroat competition so it could stabilize gross margins.

"From now on, we will grow our business with service. It doesn't make sense to do a lot of crazy things with prices," King said.

'Wholesalers' gross margins have gotten to the point where they have to be improved. They can't expect to keep pace with profits by decreasing expenses.'

— Mel Whitmire
president
Amfac Health Care

As part of its new service program, FoxMeyer has reexamined its Health Mart franchise division. King said the division has just crossed the 500 mark with members, and he thinks the new Health Mart will be able to attract 125 to 150 new members a year.

King said FoxMeyer is also seeing growth in its Health Care Pharmacy Provider program, which tries to help chain and independent drug store operators by securing HMO contracts for them.

King also said the recent acquisition of Zahn should also give the company a much stronger presence in the Chicago market.

Last February, FoxMeyer also opened a 90,000-square-foot facility in La Cross, Wisc., which will serve as a prototype.

FoxMeyer is also slowly but surely expanding its product mix. Home health care, including durable medical equipment and generic drugs, are targeted.

Amfac Health Care

In Burlingame, Calif., Mel Whitmire, president of Amfac Health Care, said his company has been having an "excellent year," adding that Amfac's experiences are unique to the industry because the company was late in automating, consolidating and adding value-added services.

"Our improvements have been outstanding," he said, "because we're just now catching up with the industry in the things that improve profitability."

Whitmire said that the lack of inflation in recent years has been good for the industry because it has "caused wholesalers to look closely at their gross margins. Wholesalers' gross margins have gotten to the point where they have to be improved. They can't expect to keep pace with profits by decreasing expenses."

How Amfac cultivates hospital business is an example of Whitmire's intent to measure the profitability of a customer. Many wholesalers have gone charging after hospital contracts only to get hurt as they realized how difficult it was to make money dealing with the average low margins and the longer payment terms.

Amfac, however, has been very successful with its hospital business. Hospitals have gone from a 4-percent mix of business in 1985 to over 30 percent today.

Amfac's retail sales are growing, and Whitmire said the company is selling more OTCs today than ever before. However, pharmaceuticals still account for between 80

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The changing customer base for today's drug wholesaler

(The percentage of business the average drug wholesaler does with each customer segment)

Customer segment	% of average wholesaler's business mix
Independents	49.60%
Hospitals: Pharmaceutical sales	20.40
Direct deliveries to chain drug stores	10.40
Chain warehouses	6.40
Independent retail buying groups	4.00
Food/grocery/drug/combo store chains	2.40
Mass merchandisers	2.10
Clinics	1.20
HMO's (all types)	0.70
Nursing home suppliers	0.60
Mail order houses	0.40
Hospitals: OTC sales	0.40
Home health care store operators	0.40
Hospitals: medical/surgical supply sales	0.30
Other	0.30
Nursing homes direct	0.20
Physicians/corporations with own formularies	0.10
PPO's including PSAO's	0.02

Source: *Drug Store News*/NWDA 1988 Wholesaler Survey

Wholesalers **TRENDS**

Drug wholesalers show price restraint

Continued from page 20

percent and 85 percent of all Amfac's sales because of the volume of business they do with hospitals.

Home health care has been identified as another growth area.

Earlier this year, Amfac became the first drug wholesaler to successfully implement a leveraged buyout.

Right now, there are 12 partners including Whitmore who is one of three major investors who own about 10 percent of the company's stock. Whitmore says he wants to make more stock available to about 38 other potential investors as "incentives" for the company to prosper.

"We have a three-year plan that will increase our stock ownership to 20 percent if we make our sales and profit goals," he says. "I want to share our stock so there'll be incentives to help us reach that goal."

Since the LBO was made final, Amfac has been awarded two major contracts. Like Cardinal, they were one of nine wholesalers chosen as suppliers for the Voluntary Hospital Association, and they were also awarded a three-year contract with the second largest HMO in Washington.

Humiston-Keeling

In Chicago, Humiston-Keeling has been concentrating on consolidation and automation to build its bottom line.

'The public knows the average prices of most pharmaceuticals, but there are hundreds of blind items that no one knows what the cost is.'

—Burton H. Olin
president
Humiston-Keeling

ufacturers are using the industry's money "for three to six months without any guilt at all."

Right now about 30 percent of H-K's sales are with hospitals, and Olin says H-K is not trying to grow that end of the business much further. Instead, they are trying to court new retail customers, but he's concentrating more on drug stores and not trying to reach the food or mass merchandise chains yet.

H-K is trying to expand its product mix to include more H&BA and deal items into its warehouse.

"The public knows the average prices of most pharmaceuticals," he says, "but there are hundreds of blind items that no one knows what the cost is. We want to buy more of that for our customers, so they can advertise candy at four for $1 or whatever and give their customers a real value."

Olin says H-K also plans to expand its private label line from about 12 items now up to 50, and carry more specialty SKUs. "We want to create the departments that chain drug stores have," he said, "automotive, hardware, even soft goods maybe.

Owens & Minor

Owens & Minor had a fairly good year last year. Earnings were up about 8.5 percent, but profits in the drug wholesaling business were flat, primarily due to internal accounting, according to chairman Gil Minor, Jr.

The Miami distribution center was losing some money, but Minor says the company corrected that problem by merging that division with O&M's medical surgical sales division.

"Our core business is profitable, but Miami was a loser. Now that it's merged with medical/surgical, it's not that much of a loser."

Minor says his company is continuing to try to reduce expenses. He says it has been able to improve productivity by increasing sales per employee through automation.

"I don't how much room is left to reduce operating costs in the industry," he says. "But you won't see the dramatic improvements you've seen in the past."

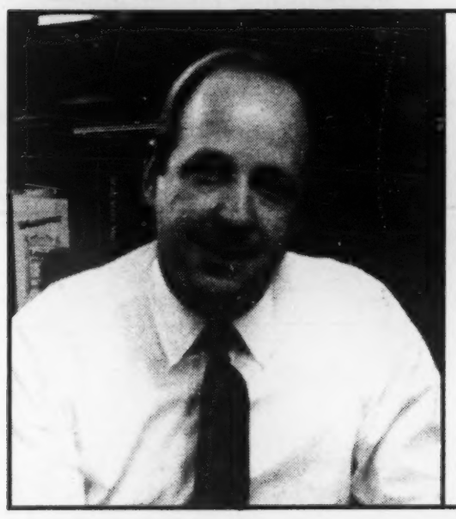
Minor says he sees two major factors working against the industry as companies try to improve overall margins and profitability. The first is the growing share of low margin business that is going through hospitals.

Minor says that about 55 percent of his business now is with hospitals so O&M has managed to "go through that phase of learning to deal with lower margins."

He said the other problem is that retail customers have formed buying groups and are continuing to put pressure on wholesalers for lower margins and lower prices.

"So it's a double squeeze going on and I don't know when it will stop."

Owens & Minor is trying to add more services like planograming to help its retail customers, and the company is slowly expanding its product mix to include more front end items.



'Prior to OCP, we were cash-poor for about two years, and we lost a lot of discounts.'

—Anthony Denicola
vp-marketing
Ketchum & Co.

Chairman Burt Olin says the company consolidated four divisions in the last four months and is now doing close to $400 million in sales from its one distribution center here, which helped to improve service levels by as much as 8 percent in some areas.

Olin says that now that the costs of shutting down existing operations are behind him, he expects to see "great strides in profitability" this year, but he doesn't think the industry as a whole is moving in a direction that will yield higher margins or profits.

He blasts one competitor for "destroying the hospital market by charging cost plus 0.8 percent. You can't run a profitable operation with that type of gross," he says. "They're offering seven days a week delivery, twice a day. They're trying to get us out of business by forcing us to meet their prices."

Olin also says the charge-back situation at hospitals has worsened. He says some man-

Ketchum

After several unprofitable years, Ketchum & Co. is starting to move toward the black.

Ketchum's vp-marketing Anthony Denicola says new parent, OCP is investing millions to help Ketchum renovate and modernize.

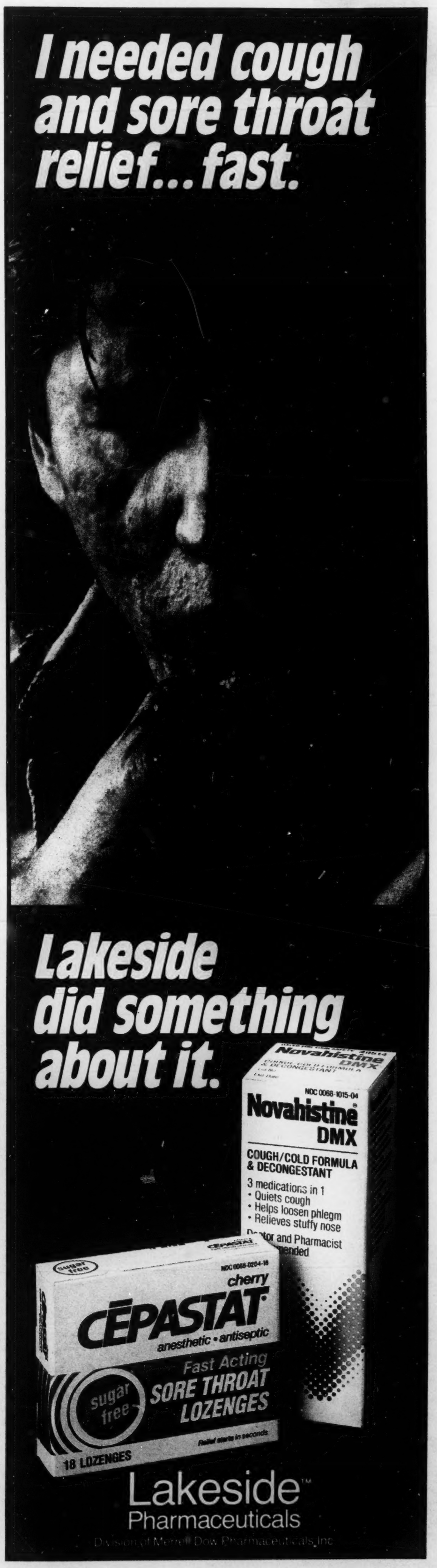
"One of the major changes since they acquired a 55 percent interest in us," says Denicola, "is that we've improved our cash flow. Prior to OCP, we were cash poor for about two years, and we lost a lot of discounts because we didn't have the money to take advantage of them."

Now Ketchum has improved its inventory position, and they are able to buy in quantities large enough to qualify for discounts.

They've also been able to modernize their largest and highest volume distribution center in Brooklyn.

Ketchum also has a new marketing plan that calls for expansion in the H&BA, OTC and generic categories. Denicola says the company has tripled its generic business in the past four months.

The company is also planning to put in a "meaningful home health care program."



Bergen Brunswig's DC 'a cost-saving prototype'

VALENCIA, Calif. — Bergen Brunswig, the nation's second largest drug wholesaler, recently released an interim report on its uniquely designed state-of-the-art distribution center, which opened last March here.

Bergen's president Phil Engle says Valencia could generate cost savings for Bergen and will probably become the prototype for all of Bergen's future high volume warehouses.

The report described the facility as follows:

The 208,100-square-foot building has space for offices and administration and expansion space above the office area.

Additionally, the design of the warehouse will accommodate a future mezzanine area. Fully expanded, the total space available is nearly 300,000 square feet.

The computer room has special acoustical treatment and secured access and fire suppression equipment, in addition to a magnetic synthesizer that monitors electrical power.

Receiving doors are equipped with dock levelers. Shipping docks have double roller conveyors that handle totes for each delivery run.

Warehouse lighting is computer controlled with an energy management system. The office heating and air conditioning system is linked to an automatic setback system. Overall, the facility employs a five-layer, cable-linked computer architecture to control automation and business requirements.

The Automated Picking System (APS) is designed to store and dispense the fastest moving prescription drugs and over-the-counter products. A demanding series of capability and acceptance tests continues. Current estimates indicate that the fast-moving items represent 50 percent of Valencia's total sales volume. The remaining 50 percent of the volume will be picked manually.

Two miles of conveyors

More than two miles of computer-controlled conveyors for picking and replenishment are provided by the Automated Material Handling System (AMHS). Operating together, the APS and AMHS have order picking and replenishment capacity far greater than any current Bergen Brunswig distribution center. Custom designed tote boxes are used throughout the system.

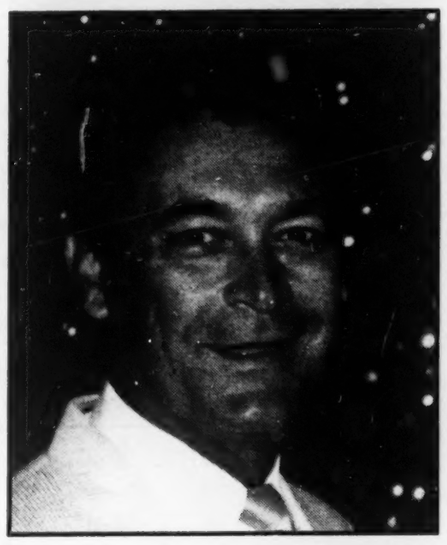
Flow rack and static shelving can store additional non-prescription product lines and additional lines of prescription medicine. Pallet-size racks provide bulk storage for some 250 truck loads of products.

Orders are filled at night for early morning delivery, but the facility has been designed for 24 hour operation, simultaneous picking and replenishment, and increased total productivity in terms of order lines per day using multiple shifts.

Bar coding of totes, cases and all inventory movement and picking documents facilitates appropriate use of the automated equipment.

Customers use an order entry terminal for telephone transmission to the IBM Series/1 order processing computer. Orders are received on a routine cycle by an IBM System 36. From this point on, the sophisticated automated procedure is significantly different from traditional order picking and materials handling methods.

When the consolidation was completed, three divisions were replaced by Valencia. The Valley Hospital division was first, then Van Nuys and Covina.



Bergen's president Phil Engle says Valencia will probably become the prototype for all of the wholesaler's future high-volume warehouses.

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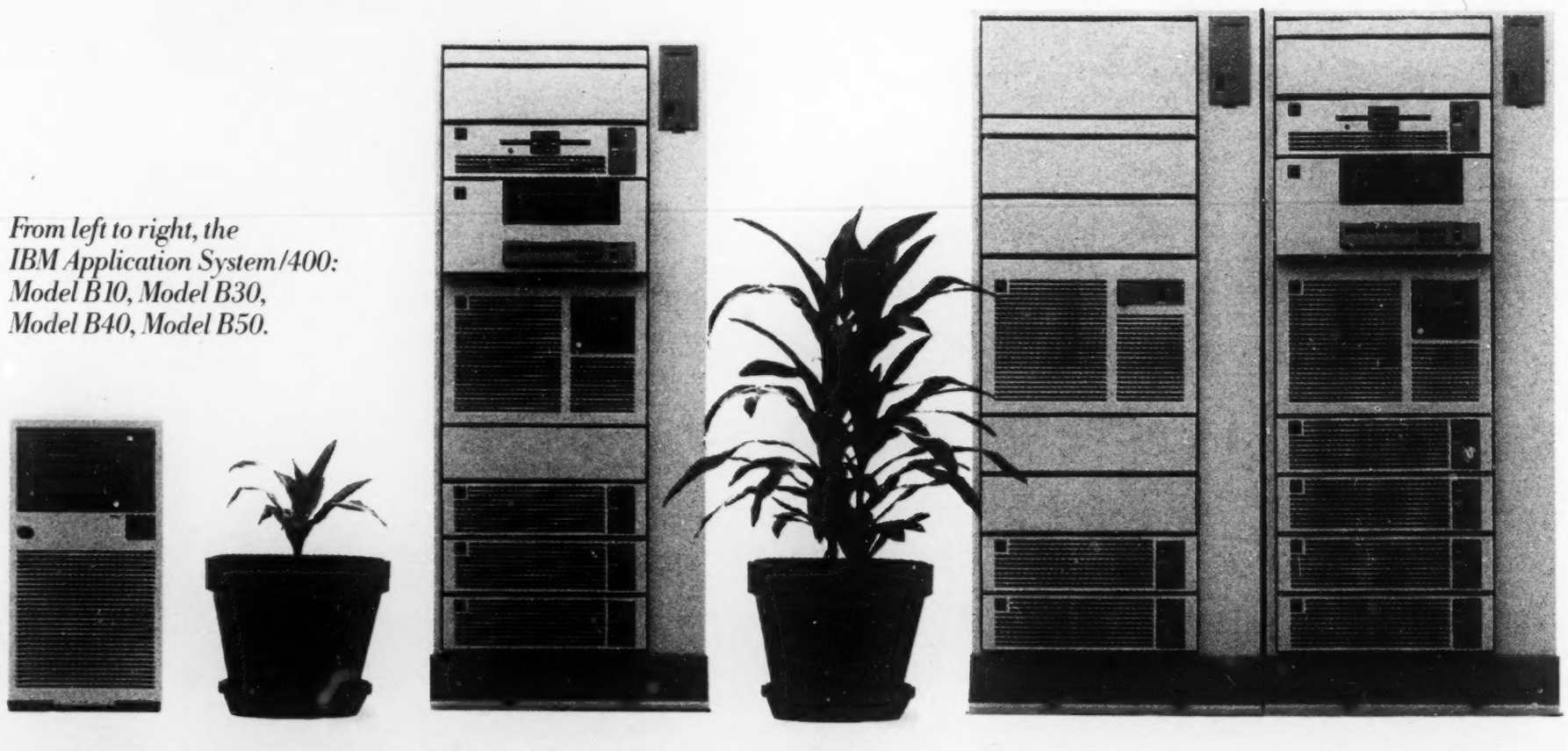

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Wholesalers TRENDS

Drug wholesaler industry profitability trends

Indicators	1983	1984	1985	1986	1987
Return on net worth	16.50%	16.40%	13.10%	9.70%	12.80%
Return on total assets	7.17	7.30	6.05	4.46	5.55
Net profit margin	1.75	1.78	1.47	1.13	1.33
Total asset turnover	4.11	4.13	3.88	3.88	4.10
Gross profit margins	10.16	9.74	8.86	8.19	7.60

Source: NWDA 1987 Operating Survey

Drug wholesalers: expense and profit trends

	1983	1984	1985	1986	1987
Gross profit*	10.16%	9.74%	8.86%	8.19%	7.60%
Operating expenses	7.21	6.84	6.17	5.98	5.28
Net operating income*	2.95	2.90	2.86	2.21	2.30

Source: NWDA 1987 Operating Survey *FIFO results

Drug wholesalers: five-year sales growth

	1983	1984	1985	1986	1987	1988 (est.)
Dollar sales (billions)	$11.90	$12.52	$14.32	$16.80	$19.40	$22.40
% chng. vs. prior year (current dollars)	16.70%	12.80%	14.80%	18.50%	16.80%	15.00%
% change adjusted for product price changes/inflation	9.72%	4.84%	8.65%	12.60%	7.00%	n.a.

Source: NWDA 1987 Operating Survey

NWDA operations survey: Good news found in controls, tax changes; inflation a question mark

Most drug wholesalers said they were somewhat heartened by the results of this year's NWDA survey of industry operations.

On a FIFO basis, net profits after taxes rose from an all time low of 1.1 percent in 1986 to 1.3 percent in 1987.

Most wholesalers told *Drug Store News* they felt at least some of the rebound was due to further cost reductions, but their optimism was also tempered by the realization that a good part of the rebound was due to changes in the tax laws, and as several sources said, the industry is still vulnerable to inflation and the prospect of increased taxes under a new presidential administration.

Return on net worth, however, was dramatically better in 1987. NWDA characterized the achievement of a 12.8 percent return in 1987 as "outstanding." In 1986, return on net worth had plummeted to an all time low of 9.7 percent.

NWDA executives pointed out that even though 1987's net worth performance is much better, it is "still below the golden years of the early 80s. In 1983, for example, the industry produced an average 16.5 percent return on net worth.

Drug wholesalers also scored again on improving their asset management in 1987. Inventory turns rose from 7.01 in 1986 to 7.07 turns in 1987.

Wholesalers also continued to expand their sku mix in all product lines except durable medical equipment (DME) and home health care. Total skus increased from an average 19,000 per house in 1986 to 19,900 in 1987.

In total, sales per sku rose from $1,954 in 1986 to $2,161 in 1987.

Because of these and other improvements, total asset turnover increased to 4.1 in 1987, up from 3.9 in 1986, the industry's best performance in this area since 1984.

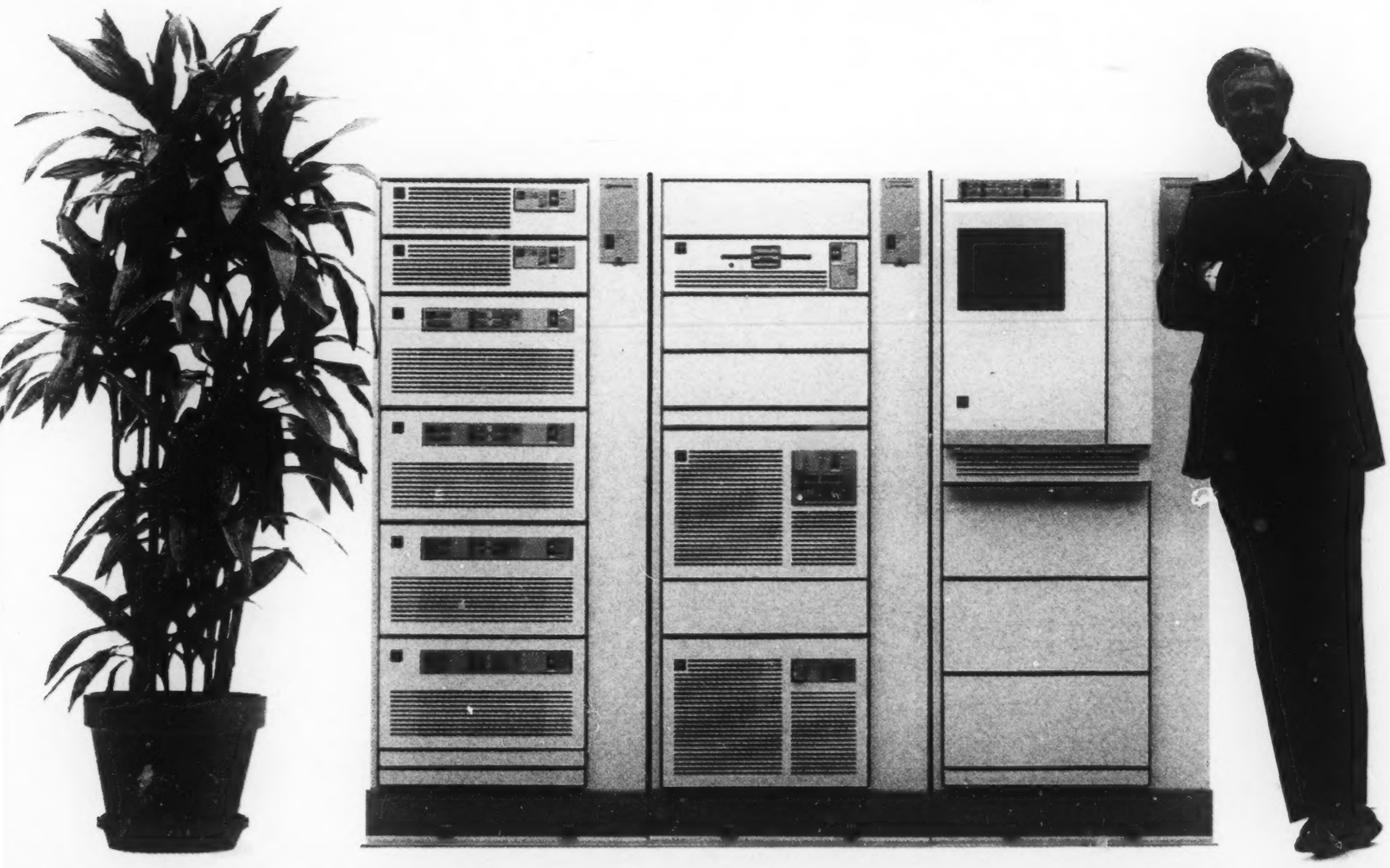
Sales for 1987 were also strong, up 16.8 percent to $19.46 billion. Since inflation increased approximately 7 percent in 1987, the industry can boast that it achieved "real growth" of 9.4 percent, a significant accomplishment.

Some of that gain came from the industry's ability to increase its share of pharmaceutical sales.

According to the Pharma-

Continued on page 24

puter growing pains. plication System/400.



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TRENDS

Wholesalers

Drug wholesalers customer sales mix

(Percentage of drug wholesale gross sales)

Customers	1979	1984	1985	1986	1987
Independents	60.71%	53.45%	50.01%	47.66%	45.60%
Chain drug	20.80	19.66	23.16	23.69	22.76
Hospitals	11.38	18.61	199.47	20.13	22.23
Chain drug warehouses	4.66	4.74	4.16	5.09	4.98
Mass merchandisers & food stores	1.64	2.26	1.96	2.25	2.53
Clinics, nursing homes, others	0.82	1.28	1.24	1.18	1.90

Source: NWDA 1987 Operating Survey

Drug wholesalers: product sales mix

(Percentage of net drug wholesaling sales)

Product Line	1979	1984	1985	1986	1987
Pharmaceutical	63.42%	71.73%*	75.75%	76.41%	78.78%
Proprietary	17.50	13.15	12.50	12.52	12.15
Toiletry	9.70	8.42	5.92	4.48	3.95
Sundry	8.32	4.96	3.75	4.27	3.14
DME & HHC**	—	—	0.57	1.05	1.06
Other	1.32	1.76	1.52	1.27	0.91

*Note: AMFAC Drug Supply rejoined the survey after being absent for several years. This may have produced some of the increases in the pharmaceutical sales percentages.

**Durable Medical Equipment and Home Health Care

Source: 1987 NWDA Operating Survey

NWDA ops survey has hopeful signs

Continued from page 23

ceutical Manufacturers Association, over 70 percent of all pharmaceutical sales went through drug wholesalers in 1987, up from 68.3 percent in 1986.

NWDA also reports that wholesaler sales to independent drug stores increased by 11.5 percent last year.

Sales to other customer segments like hospitals, however, were up much more dramatically. NWDA reports that wholesaler sales to hospital customers were up 29.0 percent in 1987.

This meant that in 1987, hospitals accounted for an even stronger percentage of total wholesaler business. In 1987, hospitals accounted for 22.2 percent of all drug wholesaler customer sales, up almost four points from 1984. Meanwhile, independents' share of total drug wholesaler sales went down two points from 1986 to 45.6 percent. In 1984, independents had accounted for a whopping 53.5 percent of all drug wholesaler customer sales.

Sales to chain drug stores also went down one point in 1987 to 22.7 percent.

Most wholesalers agree that this shift does have some impact on the continued erosion of gross margins. Hospitals are very price conscious, and they usually give their business to the lowest bidder. This means that many wholesalers have had to sacrifice gross margin profitability to build their base of business with this clientele.

So far, too, hospitals have not been as interested in retailers in obtaining "value added services" from their wholesalers. Wholesalers have been able to create an entirely new category of higher margin business by developing value-added programs for their retail customers, but hospitals until now have been more interested in buying product at the lowest possible price.

Many wholesalers think this trend will change as hospitals come to realize how wholesalers can produce management services that will make them more profitable, but until that change comes, wholesalers will have to contend with dealing with a lower margin customer base that is growing dramatically in importance to them.

In 1987, the average drug wholesaler gross margin slipped to 7.6 percent, down from 8.1 percent in 1986.

Wholesalers were able to hold the line on operating profits, however, because they were able to again lower operating expenses to 5.3 percent in 1987, down from 6.0 percent in 1986.

As a result, operating profits were up by one-tenth of a percentage point to 2.3 percent in 1987.

Profitability was also helped by a tax rate reduction: the effective tax rate went down from 48.0 percent to 38.0 percent, but as NWDA points out, that was a "one time shot in the arm" that won't recur in 1988.

Pharmaceutical sales continued to increase as a percent of the average wholesaler's sales mix. They went to 78.8 percent of all sales in 1987, compared to 76.4 percent in 1986 and 71.7 percent in 1984.

Unfortunately, higher margin front end merchandise continued to decline as a percent of product sales in the 1987 survey. According to NWDA, sundries now account for 3.1 percent of all product mix sales compared to 5 percent in 1984; toiletries are down to 4 percent compared to 18.4 percent in 1984; and proprietaries are down to 12.2 percent compared to 13.5 percent in 1984.

Most wholesalers agree that this shift does have some impact on the continued erosion of gross margins. Hospitals are very price conscious, and they usually give their business to the lowest bidder. This means that many wholesalers have had to sacrifice gross margin profitability to build their base of business with this clientele.

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